Recent Cases of Interest to Fiduciaries: Part 8 – Potpourri

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SETTLEMENT:

Bellows v. Bellows, 2011 Cal. App. LEXIS 713 (June 9, 2011)

In 2003, Beverly Bellows established a trust and named herself and her son Frederick Bellows as co-trustees. On Beverly's death, the trust assets were to be divided equally between her two sons, Frederick and Donald Bellows. Following Beverly's death in 2008, Donald requested distribution of his share of the trust. In September 2009, when the distributions had still not been made, Donald filed a petition seeking an accounting and distribution of trust assets. The court ordered that Frederick provide the accounting and distribute one-half of the trust assets to Donald within 10 days, and also awarded Donald attorneys' fees in the amount of $9,800.

Frederick mailed Donald a check for $30,376.80 that he represented was one-half of the trust assets, along with a "final trust accounting" document. Donald's attorney returned the check claiming that the amount was insufficient because Frederick had improperly deducted $13,000 of his own attorneys' fees from the trust corpus prior to the division of assets. Donald's attorney also requested documentation regarding a trust account that contained $12,000 omitted from the accounting. Frederick's attorney responded denying the existence of additional trust accounts and explaining why he believed the deduction of attorneys' fees to be proper, but nonetheless offering to give Donald half of the fees paid by the trust, or $6,718.25, "provided there was no petition forthcoming."

Frederick's attorney then forwarded a check for $37,520.48 with a letter advising Donald that he was "authorized to negotiate the check when he has signed and returned the enclosed receipt and release of final distribution." Donald cashed the check but did not sign the receipt and release.

On February 23, 2010, Donald filed a motion to compel compliance with the court's previous order seeking a full and complete accounting with documentation reflecting all sums in the original trust from 2003 through Beverly's date of death in 2008 and until final distribution in November 2009. Frederick opposed the motion and filed a cross motion for abatement because of claims regarding the management of the trust pending in a separate civil action, and requesting attorneys' fees and sanctions. Frederick argued that the motion for a further accounting should be denied because Donald had cashed the check in full satisfaction of his claim for half the trust assets.

The trial court found that by negotiating the check, Donald had agreed to the terms under which it was tendered, thereby affecting an accord and satisfaction of all obligations that Frederick owed under the trust. The court awarded Frederick his attorneys' fees for bringing the motion after Donald's acceptance of the "accord and satisfaction." Lastly, the court found that the action should be abated in favor of the civil action filed in September 2009. Donald appealed.

On appeal, the California Court of Appeals reversed and ordered the probate court to determine the sufficiency of Frederick's accounting and the merit of Donald's objection. The court found that the California trust statutes override the commercial code requirements of an accord and satisfaction, and preclude entry of an accord and satisfaction. Noting that Donald was entitled to distribution of one half of the trust assets under the terms of the trust agreement, the court found that under the California trust statutes Frederick could not condition the payment on a release of liability. The court rejected Frederick's argument that obtaining a release was authorized by the other subdivision of the statute. The court found that the trust law provisions permitting a trustee to obtain a voluntary release were inapplicable noting that, where a release is obtained as a condition to accepting payment to which a beneficiary is entitled, the release is in no sense voluntary. The court also rejected Frederick's argument that the release complied with the statute allowing a trustee to seek beneficiary approval of an accounting of trust activities where, as here, such an agreement was conditioned on Donald releasing his right to an accounting or other claims he might have against the trustee.

The court noted that a trustee may not extract from the beneficiary an agreement to accept a compromise concerning a disputed issue as a condition to receiving a distribution to which the beneficiary is unquestionably entitled. A trustee may under no circumstances condition a required distribution on an involuntary release of liability.

ARBITRATION:

Diaz v. Bukey, 2011 Cal. App. LEXIS 561 (May 10, 2011)

In 1995, Daniel and Marie Diaz established the Diaz Family Trust. In 2004, Marie Bukey was appointed as successor trustee of the trust. Marie Bukey (Bukey) and her sister Paulette Diaz (Diaz) were named as beneficiaries of the trust. In 2006, upon the death of the surviving settlor, the trust became irrevocable.

In 2009, Diaz's attorney made a written request to Bukey for a trust accounting. The accounting Bukey provided was not satisfactory to Diaz and she petitioned to remove and replace Bukey as trustee and for other relief on the grounds that Bukey breached her fiduciary duties as trustee by failing to provide a proper accounting, failing to distribute the trust assets, and using trust assets for her own personal benefit. Bukey filed a demurrer and petition for order compelling arbitration of the dispute on the grounds of the arbitration provision in the trust.

The trial court denied the petition to compel arbitration on the grounds that a trust beneficiary is not bound to submit disputes with the trustee to arbitration. Bukey appealed, asserting that the arbitration provision in the trust was binding on Diaz as a trust beneficiary under a third-party beneficiary theory or an equitable estoppel theory.

The California Court of Appeals affirmed the lower court and rejected the argument that a trust is a contract subject to the California Arbitration Act because it does not rest on an exchange of promises.

Rachal v. Reitz, 2011 Tex. App. LEXIS 5598 (July 22, 2011)

A.F. Reitz established a trust for the benefit of his son, John, and appointed himself as initial trustee and Hal Rachal Jr. as successor trustee. After A.F. Reitz died, Rachal became trustee of the trust. John sued Rachal as trustee alleging breach of fiduciary duty by failure to account and looting of the trust for personal gain. The trustee moved to compel arbitration of the suit under the arbitration provision in the trust. The trial court denied the motion and the trustee appealed. On appeal, the Texas Court of Appeals (with one dissent) affirmed on the grounds that: (1) the trust document did not satisfy the requirement for a valid contract; and (2) the settlor's intent does not transform the trust into a contract to arbitrate between the successor trustee and the beneficiary.

DISCLAIMERS:

In re matter of the S.H. Bowman Trust, 2011 Minn. App. LEXIS 119 (September 12, 2011)

Samuel Bowman Jr. created a trust for his wife's lifetime benefit and thereafter for the benefit of his children during their lives, with the assets to be finally distributed to his grandchildren at the death of each child. The trust contained a spendthrift provision.

Samuel's daughter, Anne, became a trust beneficiary following the death of Samuel and his wife. On March 10, 2010, Anne delivered a disclaimer to the corporate trustee that she signed because of the financial distress of her two daughters and their children. The trustee petitioned the court for a determination of whether the disclaimer was valid. The district court concluded that the disclaimer was invalid because the time for filing the disclaimer had expired and Anne had already accepted the interest she sought to disclaim. Ann appealed.

On appeal, the Court of Appeals of Minnesota reversed the trial court's decision based on the law applicable prior to Minnesota's enactment of the Uniform Disclaimer of Property Interests Act.

Under the prior Minnesota statute, the court noted that a disclaimer could be made either (1) within nine months of the effective date of the non-testamentary instrument creating the interest or (2) if the disclaimant had not yet been finally ascertained as a beneficiary or their interest was not yet "indefeasibly fixed both in quality and in quantity," within nine months of the event causing the disclaimant to become finally ascertained and the interest indefeasibly fixed both in quality and quantity.

The court upheld the validity of the disclaimer on the grounds that: (1) where the trust instrument contained a spendthrift provision, Anne's interest in the payments of principal and income from the trust did not become indefeasibly fixed in quality until the income was distributed; (2) because Anne sought only to disclaim her portion of future payments, Anne's interest had not become indefeasibly fixed in quality; (3) therefore the time for filing a disclaimer had not yet expired; and (4) the district court erred by treating the income stream as a single interest that had already been accepted by Anne, rendering disclaimer impossible.

TRUSTEE DISCLOSURE:

Sanders v. Stasi, 2011 Ill. App. LEXIS 731 (July 12, 2011)

Under his will, Otto Stasi created a trust that provided for several regular enumerated distributions of trust income and then directed that any excess income be paid at least annually in unequal shares among six individual beneficiaries.

One of the beneficiaries, Carol, was also named as trustee of the trust. Another beneficiary, Lisa, sued the trustee to compel an accounting and alleging breach of fiduciary duty. The trustee moved for summary judgment alleging that the trust did not earn income in excess of the required enumerated disbursements. The trial court granted summary judgment for the trustee.

The beneficiary appealed and the Illinois Court of Appeals reversed on the grounds that: (1) a trustee must furnish a current account to the beneficiaries then entitled to receive trust income; (2) Lisa was entitled to receive a distribution of income in any year where the trust income exceeded the required distributions, even if there is no actual income distributed to her in any year; and (3) Lisa would be unable to enforce her rights as beneficiary if she did not receive an accounting of the trust's receipts, disbursements, and holdings.

TRUST REFORMATION:

In re Last Will and Testament of John L. Quigley, 2011 R.I. LEXIS 99 (June 24, 2011)

Under his will and three codicils, John L. Quigley created a trust for the benefit of his wife, Jacqueline, and his five children. The trustees petitioned the court to allow certain trustee accounts, authorize payment of fees and expenses, approve the resignation of the trustees, appoint a successor trustee, and reform the trust. The trustees in part asked the court to reform the trust to conform to John's intent that distributions to the children be delayed until the latter of the death of John's wife or the children attaining the age of 25 years. Jacqueline and the children signed consents to the resignation of the trustees and appointment of a successor, but not to the reformation.

In the proceedings, the children asked for payment of their attorneys' fees. At the hearing, counsel for the children indicated that all interested persons had been notified of the requests in the petition and had agreed to relief sought in the petition. The court reformed the trust, noting that the children were the only necessary parties to the proceedings and had all consented to the relief sought, as evidenced by their affidavits of consent attached to the petition.

More than six years later, one of the children moved to vacate the order reforming the trust alleging that: (1) the order was void because the beneficiary was not served with formal process and did not accept service; (2) the reformation was not expressly discussed at the hearing; (3) the order was not sent directly to the beneficiary; and (4) the actions of the beneficiaries' prior attorney were not binding due to the lack of service of process. The successor trustee, Bank of America, objected to the motion and the trial court held that there was insufficient evidence to justify vacating the order. The beneficiary appealed.

On appeal, the Rhode Island Supreme Court affirmed the trial court on the grounds that: (1) the beneficiary received notice of the prior proceedings, signed two consent forms, and had an attorney present at the hearing; (2) the beneficiary's due process rights were not violated where the beneficiary had actual notice of the proceedings and was represented by an attorney; (3) while the consent forms did not specifically address the reformation, they put the beneficiary on notice of the petition and the court could presume that the beneficiary was familiar with the contents of the petition; (4) the attorney certified that he represented all of the children; and (5) the beneficiary's six-year delay in bringing his suit was inherently prejudicial to the other family members.

In the matter of trust for Grandchildren of Wilbert L. and Genevieve W. Gore, C.A. No. 1165-VCN

Following its judgment in *In the Matter of Trust for Grandchildren of Wilbert L. and Genevieve W. Gore*, 2010 Del. Ch. LEXIS 188, the court issued a supplemental decision addressing the validity and effect of the Pokeberry Formula and the status of an adopted adult as a trust beneficiary. (For our complete discussion of the September 2010 decision, *see* Part 1).

In 1958, Bill and Genevieve Gore founded W.L. Gore and Associates, Inc. They made various outright gifts of stock in the company to their children and set up several trusts funded with company stock for the benefit of their children and grandchildren. In July of 1971, the Gores decided they needed to adopt a new estate planning strategy to ensure that the company would remain a private company by avoiding any large sale of stock to pay estate taxes and to minimize taxes at the Gores' deaths. Bill and Genevieve hired Converse Murdoch to achieve these estate planning goals. In May 1972, the Gores created a trust for their grandchildren to effectuate their estate planning goals and funded the trust with 1,000 shares of Pokeberry Hill Securities, Inc., common stock (a holding company that owned common stock of W.L. Gore & Associates, Inc.). In subsequent months, the Gores tweaked the formula included in the May Instrument in an attempt to equalize the shares their grandchildren would eventually receive. In October 1972, the Gores signed a document incorporating various changes to the formula and changing language to reflect their decision to include adopted grandchildren in the trust.

The May instrument provided that, after the payment of taxes, the remainder would be evenly divided among all the Gore grandchildren (without the use of the Pokeberry Formula that was the subject of prior litigation). The May instrument was not found until the discovery phase of the prior litigation. Prior to its discovery, all parties believed and acted in reliance on the belief that the October instrument governed the Pokeberry Trust.

The October instrument included the Pokeberry Formula. Susan, one of the Gore children, had adopted her ex-husband, Jan, to manipulate the Pokeberry Formula to increase the share in the trust for her children. In the prior suit, the Delaware Court of Chancery held that Jan was barred from claiming any personal economic benefit from the Pokeberry Trust due to his unclean hands.

Susan's children asserted that the May instrument created an irrevocable trust, rendering the October instrument (which included the Pokeberry formula) invalid. The court held that while the May instrument did create a trust, the trust was revocable despite language in the instrument itself indicating that the trust was irrevocable, on the grounds that: (1) counsel indicated that to effectuate their estate plan, the Gores needed to create and fund the trust quickly but also needed to obtain IRS approval, which could take several months; (2) the Gores' knowledge that disastrous consequences (from an estate tax perspective) could result if something were to happen to them before the IRS approved the plan and the stock was still part of their estate; (3) the Gores never told anyone about the May instrument and never requested a taxpayer ID for the trust; and (4) the Gores' actions and communications in the days following execution of the May instrument indicated their intent to reserve the right to revoke the May instrument.

The court upheld the Pokeberry Formula as consistent with the Gores' intent, but held that Susan's adoption of Jan was invalid on the grounds that: (1) it was undertaken for purposes not widely recognized as a proper exercise of the authority granted by the Delaware adoption statute and with the sole improper goal of thwarting or circumventing the Gores' intention regarding the Pokeberry Trust; and (2) rewarding the manipulation of the law by giving Jan the status of a grandchild under the Pokeberry Trust would be inconsistent with the seminal rule of construction in Delaware trust and wills cases – that the intent of the settlor or the testator is central to the interpretation of the given instrument and that such intent must be determined by considering the language of the trust instrument, read as an entirety, in light of the circumstances surrounding its creation.

The court also rejected Jan's argument that an enforceable agreement existed between Jan and Susan entitling him to a "comfortable retirement" due to his participation in the adoption. Lastly, the court rejected an attempt by Susan and her children to enforce a settlement agreement negotiated in mediation in 2007 providing that the Pokeberry Formula would not be applied, on the grounds that not all of the trust beneficiaries were parties to the agreement.

Buchanan, et al v. Bank of America, N.A., 2011 R.I. Super LEXIS 115 (August 17, 2011)

The individual trustees of nine irrevocable trusts filed nine individual petitions to remove Bank of America (the successor by merger to the original trustee) as corporate trustee and to substitute Coastline Trust Company in Bank of America's place. Coastline was serving as investment manager for the trusts and was owned in part by family members. Each of the trusts required that there be both an individual and a corporate trustee. The individual trustees sought removal of the trustee under (1) the doctrine of equitable deviation as set forth in Section 66 of the Restatement (Third) of Trusts and (2) Section 706(b) of the Uniform Trust Code that provides for removal of a trustee regardless of fault. Bank of America moved for summary judgment asserting that neither Section 66 nor Section 706(b) could serve as the basis for a contested trustee removal. The trial court granted summary judgment in favor of Bank of America on the grounds that: (1) the restatement provision allowing modification of a trust due to circumstances unanticipated by the settlor does not provide a means by which to remove or replace the trustee; (2) Section 706(b) of the UTC does not constitute a substantial change of circumstances contemplated by the statute and justifying removal; (3) the Rhode Island legislature had not yet adopted Section 706(b); and (4) the court had previously rejected a no-fault approach to trustee removal.

JURISDICTION:

Elinoff v. UBS Financial Services, Inc., 2011 U.S. Dist. LEXIS 78913 (July 20, 2011)

Linda Elinoff was listed as the sole beneficiary of an IRA owned by Mildred Siegel and held at UBS Financial Services, Inc. After Mildred's death, Linda contacted UBS to transfer the account to herself. Mildred's executor made a competing claim to the account on behalf of the estate. Linda sued UBS in federal district court under diversity jurisdiction. UBS moved to interplead the assets and also filed a third-party complaint against the executor. The executor moved to dismiss the suit for lack of subject matter jurisdiction and under the probate exception to federal court jurisdiction.

The court held that diversity jurisdiction was proper on the grounds that, although the adverse claimants, Linda and the executor, were both citizens of Illinois, the original complaint met the diversity jurisdiction requirements and the third-party complaint filed by UBS did not divest the district court of jurisdiction. The court, however, held that the probate exception applied because the practical effect of Linda's suit would be similar to a successful will contest because Linda sought possession of a portion of Mildred's assets, and there was currently pending a probate proceeding regarding Mildred's assets and estate.

SPENDTHRIFT PROVISIONS:

Fannie Mae v. Heather Apartments Limited Partnership et al, 2011 Minn. App. LEXIS 68 (June 6, 2011)

Andrew Grossman's father established a revocable trust in 1983. Under the trust agreement, upon Andrew's father's death and after certain distributions had been made, the trustee was to divide the balance of the trust estate into equal shares for Andrew and his siblings outright and free of trust. The trust contained a spendthrift provision.

In August 2007, Fannie Mae obtained a $7.5 million judgment against Andrew in Oklahoma. The judgment was docketed and Fannie Mae deposed Andrew about his assets in the action to enforce the judgment. Andrew testified that (1) he transferred his interests in several corporate entities (worth $8 million) to an offshore trust in the Cook Islands two or three months before the deposition; (2) he liquidated his IRA and placed the $400,000 proceeds in the Cook Islands trust; and (3) his children were the beneficiaries of the Cook Island trust.

Andrew's father died in January 2010. The next month, Fannie Mae filed an *ex parte* motion for a temporary restraining order to prohibit Andrew from transferring or disposing of any assets that he had received, was due to receive, or would receive as a result of the death of his father. The district court granted the motion and enjoined Andrew from transferring or disposing of any interest as a result of the death of his father. Later, the court converted the temporary restraining order into a temporary injunction. Fannie Mae also moved the district court for an application of assets to satisfy its judgment against Andrew. The court granted the motion, appointed a receiver to take custody and liquidate all inheritance proceeds of the trust, which were eligible for distribution as they came due, and to apply the proceeds to Fannie Mae's judgment. Andrew appealed.

On appeal, the Minnesota Court of Appeals reversed on the grounds that: (1) state law did not give the court authority over proceeds not within a person's possession or control, and therefore did not authorize orders affecting proceeds of a spendthrift trust that may be distributed to a beneficiary in the future; and (2) proceeds of a spendthrift trust are inviolable until actually received by the beneficiary, and therefore the district court may not, before proceeds of a spendthrift trust are received by a beneficiary, determine what a beneficiary may or may not do with the proceeds.

TERMINATION:

The Convention of Protestant Episcopal Church of the Diocese of Washington v. PNC Bank, N.A., 2011 U.S. Dist. LEXIS 61289, June 6, 2011

Under her will, Ruth Gregory Soper gave various outright bequests and also established a perpetual chartable trust (after the satisfaction of the interests of various individuals) in her memory for the benefit of the Convention of the Protestant Episcopal Church of the Diocese of Washington. Mrs. Soper named a corporate predecessor to PNC Bank as trustee.

After Mrs. Soper's death, the trust was amended in 1975 with the written consent of all of the beneficiaries to preserve the trust's charitable deduction due to a change in federal tax law. The 1975 amendment included a spendthrift clause and also provided for selection by the trustee of a new charitable beneficiary for the trust in the event the diocese failed in the future to qualify as an organization described in Internal Revenue

Code Sections 170(c) and 2005(a). Thereafter, the trust was converted with the consent of the diocese to a total return unitrust. After the death of the individual trust beneficiaries, the trust assets grew to $23 million and the trustee continued to make significant annual distribution to the diocese.

The diocese sued in state court to force the termination of the trust, alleging that: (1) as the claimed sole beneficiary of the trust, it had the unanimous consent of the beneficiaries required to terminate the trust; (2) termination would not be inconsistent with the settlor's charitable intent; (3) the continued payment of administrative fees to PNC burdened the trust and its sole charitable beneficiary; and (4) the spendthrift provision of the trust did not prevent termination because it was added after Mrs. Soper's death.

The trustee removed the suit to federal court, and moved to dismiss the suit on the grounds that: (1) the diocese did not have the unanimous consent of all potential beneficiaries to terminate the trust because the Maryland attorney general, who represented the interest of the contingent charitable beneficiaries and the public, did not consent to the termination; and (2) the trust contained a valid spendthrift provision that the diocese approved as part of the 1975 reformation, and that provision precluded termination of the trust.

The federal district court denied the motion to dismiss the suit on the grounds that: (1) the Maryland attorney general was not a necessary party because he indicated that he did not intend to participate in the proceedings; (2) the possibility that the diocese might lose its charitable status or cease to exist was so remote that the consent of the contingent successor charitable interest to the termination was not required; and (3) the spendthrift clause could not establish that terminating the trust would be inconsistent with a material trust purpose since it was added after Mrs. Soper's death.

LIMITATIONS ON ACTIONS:

Edwards v. BancFirst, 2011 Okla. Civ. App. LEXIS 85 (June 30, 2011)

Patricia Bowers Edwards's mother, Eloise Bowers, died in 2001. During her lifetime, Eloise established the Eloise Coopers Bowers Trust with BancFirst as trustee, and also established the Bowers Foundation. At Eloise's death, the foundation was to receive her remaining assets valued at approximately $7 million.

Patricia sued successfully to dissolve the foundation on grounds of undue influence, and the judgment was upheld on appeal. In 2003, BancFirst filed the estate tax return for Eloise's estate claiming no taxes due. As a result of the suit to dissolve the foundation, the IRS questioned the $7 million deduction for assets that were to go to the foundation and assessed approximately $4 million in federal estate tax. The IRS and BancFirst reached an agreement that permitted BancFirst to delay payment of estate taxes pending the outcome of Patricia's lawsuit. However, under the agreement the delay was not to exceed the limitations period for filing the tax assessment for taxes due.

In June 2007, the Bank of Oklahoma was substituted as trustee of the trust by court. The appeals were concluded and the judgment terminating the foundation became final on December 15, 2008. However, the Bank of Oklahoma did not pay the federal estate taxes plus interest of $1,000,200 owed until February 2009.

Patricia filed suit against BancFirst as trustee, alleging negligence for failing to pay the federal estate taxes along with a protective refund claim, thereby stopping the accrual of interest on the taxes owed, and sought $724,000 in damages. BancFirst asserted the statute of limitations as a defense to the claim, and also disputed any harm to the trust as a result of the investment return on the assets that were not applied to the payment of federal estate taxes.

The trial court held that: (1) the statute of limitations on any claims against BancFirst commenced in June 2007 when BancFirst transferred the trust assets to Bank of Oklahoma, because at that time Patricia had all the information concerning the taxes due, the nonpayment of taxes, and the accrual of interest; (2) the Bank of Oklahoma was the real party in interest as of the date of the transfer and, at that time, had the standing and information necessary to bring the claim for not paying the taxes; (3) Patricia first asserted her claim in her deposition on January 11, 2010, and her claim was time barred. Patricia appealed the trial court's ruling on the basis that her initial lack of standing delayed the beginning of the statute of limitations period.

On appeal, the Oklahoma Court of Appeals affirmed the trial court on the grounds that the two-year statute of limitations period began when Bank of Oklahoma became the successor trustee and was not tolled during the period before the bank relinquished the claim to her.

In re Stephen M. Gunther Revocable Living Trust, et al v. Gunther, 2011 Mo. App. LEXIS 1293, October 4, 2011

In 1997, Stephen Gunther (Stephen) established a revocable trust with J. Barry Gunther (Barry) as initial trustee. In 2006, Stephen amended the trust to name himself as trustee and change the residuary beneficiary upon his death to his then living descendants, subject to a contingent trust for any beneficiary under the age of 25. Stephen died in 2009 survived by his wife, Angel Gunther, and their two minor children, Alton and Adam Gunther.

One year after Stephen's death, the beneficiaries sued Barry (by their mother as next friend) with respect to his actions as trustee during Stephen's lifetime, and sought an accounting, enforcement of the trust, removal of the trustee, and surcharge of the trustee. The trial court entered summary judgment against the beneficiaries in favor of the trustee finding that the trustee owed no duty to the beneficiaries prior to Stephen's death and beneficiaries were not entitled to an accounting for transactions prior to that date. The beneficiaries appealed. On appeal the Court of Appeals of Missouri affirmed, applying the Missouri Uniform Trust Code and confirming that under the UTC the trustee (1) had no fiduciary relationship with the beneficiaries until the death of the settlor and thus the trustee had no duty to account to the beneficiaries before that date and (2) wed his duties exclusively to the settlor of the revocable trust prior to his death.